Supreme Court, U.S.
FILED
JAN 25 1995
OFFICE OF THE CLERK

No. 94-1120

IN THE
Supreme Court of the United States
OCTOBER TERM, 1994

CENTURY-NATIONAL INSURANCE CO., *et al.*,
Petitioners,

v.

CHARLES QUACKENBUSH,
Insurance Commissioner of California, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the Supreme Court of California

---

REPLY BRIEF FOR PETITIONERS

KENT KELLER
ROBERT W. HOGEBOOM
STEVEN H. WEINSTEIN
BARGER & WOLEN
515 South Flower Street
Los Angeles, CA 90071

CARLA J. BENNETT
ADAMS, DUQUE & HAZELTINE
777 South Figueroa Street
Los Angeles, CA 90017

H. BARTOW FARR, III
(Counsel of Record)
RICHARD G. TARANTO
FARR & TARANTO
2445 M Street, NW
Washington, DC 20037
(202) 775-0184

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

11 pp

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
CONCLUSION	8

TABLE OF AUTHORITIES

Cases — Page

Agins v. Tiburon, 447 U.S. 255 (1980) 3
FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944) ..... *passim*
First English Evangelical Lutheran Church v. Los Angeles, 482 U.S. 304 (1987) 8
Kaiser Aetna v. United States, 444 U.S. 164 (1979) 3
Keystone Bituminous Coal Ass'n v. DeBenedictis, 480 U.S. 470 (1987) 3
New Orleans Pub. Serv., Inc. v. Council of New Orleans, 491 U.S. 350 (1989) 3
Pacific Gas & Elec. Co. v. State Energy Resources Conserv. & Dev. Comm'n, 461 U.S. 190 (1983) 3
Pennell v. San Jose, 485 U.S. 1 (1988) 3
Prentis v. Atlantic Coast Line Co., 211 U.S. 210 (1908) 3
Yee v. Escondido, 112 S. Ct. 1522 (1992) 2

Other Materials

J. Bonbright, A. Danielsen, & D. Kamerschen, *Principles of Public Utility Rates* (2d ed. 1988) 5
S. Breyer, *Regulation and Its Reform* (1982) 5
National Association of Regulatory Utility Commissioners, *Utility Regulatory Policy in the United States and Canada, Compilation 1993-1994* (1994) 6

IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

No. 94-1120

CENTURY-NATIONAL INSURANCE CO., *et al.*,
Petitioners,

v.

CHARLES QUACKENBUSH,
Insurance Commissioner of California, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the Supreme Court of California

---

REPLY BRIEF FOR PETITIONERS

The Commissioner opposes the petition on essentially two grounds. First, he argues that petitioners' facial challenge to the California Supreme Court's expressly announced confiscation standards is not ripe for this Court's current consideration. Br. in Opp. 7-9. Second, he argues that, in any event, the decision below does not warrant review, chiefly by suggesting that the decision does not actually rest on the rationale stated by the California Supreme Court. *Id.* at 10-17; *see also* 94-1119 Br. in Opp. 5-24. Neither argument bears scrutiny.

The first objection reflects a plain misunderstanding of ripeness law as it applies to the particular question presented for review. The second objection rests entirely on studied disregard of, and efforts to distract the Court from, the express rationale of the decision below. In fact, the case squarely and properly presents the entirely legal question whether the market-based cost-of-capital standard of *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), states a constitutional minimum for non-confiscatory rate regulation. Aside from the attempts to avoid that question, the Commissioner's briefs (in this case and in No. 94-1119) say nothing to dispute the obvious importance of this issue.

1. The Commissioner's primary argument against review of the facial takings challenge is that the question presented is not ripe for review. *See* Br. in Opp. 7-9.[1] But this argument is flatly inconsistent with this Court's clear holdings that the ripeness of a takings claim, as of any other type of legal claim, depends on the nature of the particular claim advanced. The Commissioner's ripeness objection, and the authorities cited in support, have no application to the question presented here, which does not ask this Court to resolve an as-applied claim of confiscation, but raises a purely legal issue wholly suitable for, and urgently demanding, immediate resolution.

Thus, in *Yee v. Escondido*, 112 S. Ct. 1522, 1531-32 (1992), the Court expressly distinguished as-applied takings claims from facial claims and held that a facial claim *was* ripe where that claim was neither hypothetical in character nor otherwise dependent for its resolution on facts insufficiently developed in the record, such as the extent of particular harm to a particular claimant. In so

[1] Notably, the Commissioner does not make any ripeness objection in No. 94-1119, which, in addition to an as-applied challenge, involves the same facial challenge to the Commissioner's regulations as does this petition. Nor did the Commissioner present a ripeness objection to the facial challenge in the California Supreme Court, which, of course, resolved this challenge on the merits.

holding, the Court followed prior rulings to the same effect. *See, e.g., Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 495 (1987); *Agins v. Tiburon*, 447 U.S. 255 (1980). None of the five decisions cited by the Commissioner on the ripeness issue says anything to the contrary.[2]

Here, the question raised by petitioners' facial challenge, and presented for review to this Court, is entirely legal and wholly fit for resolution in the current posture of this litigation. *See Pacific Gas & Elec. Co. v. State Energy Resources Conserv. & Dev. Comm'n*, 461 U.S. 190, 200-01 (1983) (ripeness standards). The California Supreme Court, applying the state-law requirement that rates be set no higher than the minimum level necessary to avoid confiscation, has declared that level to be lower than the *Hope* cost-of-capital standard.[3] The question pre-

---

[2] Of the five cited decisions, four plainly involved no holding that a facial takings claim was unripe. *See Kaiser Aetna v. United States*, 444 U.S. 164 (1979) (adjudicating and finding a taking); *New Orleans Pub. Serv., Inc. v. Council of New Orleans*, 491 U.S. 350 (1989) (preemption, not takings, question at issue; holding that abstention was improper and claim should be adjudicated); *Prentis v. Atlantic Coast Line Co.*, 211 U.S. 210 (1908) (exhaustion of state non-judicial processes required for as-applied confiscation claim); *FPC v. Hope Natural Gas Co., supra* (adjudicating as-applied confiscation claim).

In *Pennell v. San Jose*, 485 U.S. 1, 9-11 (1988), the Court held that it would be "premature" for this Court to resolve a particular facial takings claim, but that holding was based on a circumstance not present here: the particular claim at issue challenged the authority of regulators to consider a particular factor (tenant hardship) in limiting permitted (rental) rates, yet there was no indication that the challenged factor ever had been, or in the future would be, actually relied on as a ground for limiting rates. (Justice Scalia, with Justice O'Connor, dissented as to ripeness and went on to find a taking.) The hypothetical character of the claim in *Pennell* has no counterpart here.

[3] The Commissioner's regulations state that rollback rates must be reduced to whatever level is minimally nonconfiscatory (or 80% of the 1987 rate if that is higher). *See* Pet. App. 20a-21a. The

sented—whether the state-law requirement of rates below the *Hope* standard is on its face inconsistent with the Takings Clause—does not turn on any facts about the requirement's impact on particular companies. It turns only on the legal standards required by *Hope* and the Fifth Amendment: that is, whether a law limiting companies to something less than the return specified by *Hope* is constitutional. That is why the California Supreme Court adjudicated the issue on the facial challenges presented in this "test case" (Pet. App. 34a), just as it had adjudicated the facial challenge to Proposition 103 in the earlier *Calfarm* case.

Not only is the issue fit for immediate resolution, but there is nothing remotely hypothetical about the impact of the standards adopted by the court below. Virtually all of petitioners already have been subjected to refund orders under those standards, in amounts totalling hundreds of millions of dollars. *See* Pet. 13 n.10.[4] There is nothing to be gained, and considerable resources in wasteful litigation to be lost, by postponing resolution of the purely legal question presented for this Court's decision on behalf of these parties who are directly affected by the state court's resolution of that question. The facial challenge in the two petitions for certiorari is fully ripe for decision along with 20th Century's as-applied challenge.

2. The Commissioner's remaining argument against review (Br. in Opp. 10-16; 94-1119 Br. in Opp. 5-24) rests on varied attempts to avoid the question presented. The most remarkable is the Commissioner's steadfast refusal in either of his briefs ever to quote or acknowledge the expressly stated rationale of the decision below. The

---

California Supreme Court then construed the "minimally nonconfiscatory" standard, which has thus been incorporated as the state-law standard, *not* to require an opportunity to recover the firm's cost of capital. *See* Pet. 7-9.

[4] In addition to the refund orders noted at Pet. 13 n.10, we note that after the petition was filed, the FARMERS companies were ordered to pay $183 million in rollback-year refunds.

inescapable fact is that the California Supreme Court repeatedly stated, and repeatedly described as the key to its ruling, its view that Fifth Amendment confiscation standards do not entitle a regulated firm to earn a return based on the firm's cost of capital as defined in *Hope*. *See* Pet. App. 76a-85a, 112a-116a, 123a-124a; Pet. 7-9. The Commissioner's assiduous ignoring of the California Supreme Court's central holding betrays a telling embarrassment about its rationale.

Rather than face what the California Supreme Court said, the Commissioner advances his own interpretation of *Hope* and argues that the California Supreme Court did not reject that interpretation. Br. in Opp. 10-11; 94-1119 Br. in Opp. 9-14. But this response sidesteps the issue presented. The repeated holding of the California Supreme Court was, in terms, that the cost-of-capital standard set forth in *Hope* does not state a constitutional minimum. *See* Pet. App. 76a-85a, 112a-116a, 123a-124a; Pet. 7-9. That holding cannot be rewritten somehow to become an affirmation that *Hope*, construed in some other way, does state a constitutional minimum. Moreover, to the extent that the Commissioner suggests that the *Hope* cost-of-capital standard means something other than the "rate of return available in the marketplace on investments comparable in terms of risk and otherwise" (Pet. App. 30a), its construction differs not only from that of the California Supreme Court (just quoted) but from the accepted understanding of the decision as it is generally followed. *See*, *e.g.*, S. Breyer, *Regulation and Its Reform* 43 & n.20, 43-47 (1982); J. Bonbright, A. Danielsen, & D. Kamerschen, *Principles of Public Utility Rates* 316 (2d ed. 1988) (*Hope* establishes "opportunity cost principle," entitling investors to "expected return . . . equal to the returns they could expect on an investment of comparable risk elsewhere in the economy").[5] The

[5] There are various methods of approximating that expected market-based return. Virtually all state regulators set rates of

decision from which certiorari is here being sought rejects the *Hope* cost-of-capital standard as a constitutional minimum, and does so on the widely accepted understanding of that standard.

The Commissioner's other main strategy for trying to alleviate concern about the California Supreme Court's decision is to repeat the number "10 percent" pervasively in his briefs, as if incantation of a superficially reasonable-sounding return could, by itself, answer the legal question presented. But this strategy only highlights how unwilling the Commissioner is to come to grips with the basis of the California Supreme Court's decision. That decision squarely and openly rests on the repudiation of the *Hope* cost-of-capital standard as a constitutional entitlement, *not* on any conclusion that the *Hope* standard is *satisfied* by an end result of a 10% return. Indeed, the California Supreme Court rejected the confiscation claim of 20th Century after expressly accepting that its particular cost of capital was 20%. Pet. App. 116a.

The Commissioner's 10% figure is a red herring for a number of other reasons as well. Even as to 20th Century, the Commissioner still has not shown that the end result actually is a 10% return under the California Supreme Court's own method of calculating that result. To the contrary, amidst a confusing discussion of irrelevant matters (Br. in Opp. 12-14), the Commissioner conspicuously avoids ever disputing our simple showing that the state court's method in fact produces a return of roughly 8%—less than the Commissioner himself determined to be the constitutional minimum. Pet. 10 n.8. The same flaw in the Commissioner's reliance on the 10% figure applies more generally: the Commissioner's intimation of 10% as a general "end result" is quite simply

---

return using some or all of those methods. *See, e.g.*, National Association of Regulatory Utility Commissioners, *Utility Regulatory Policy in the United States and Canada, Compilation 1993-1994* at 290, 463, 516, 546 (1994).

baseless. Rather, the 10% figure he repeatedly invokes is only the rate of return that is *plugged into* the formula, but *like the California Supreme Court*, the Commissioner has said nothing to show that the complex formula is calculated to *result* in a 10% rate of return.[6] Beyond that, the 10% figure would seem irrelevant under the Commissioner's own asserted view of the minimum constitutional standards: in his view, a 10% return meets constitutional standards "and then some" (94-1119 Br. in Opp. 16), and regulatory authorities' "orders that protect only out-of-pocket expenses—that leave *no profit* at all"—are constitutional (*id.* at 21 n.15).[7]

---

[6] The California Supreme Court upheld the formula without disturbing the trial court's finding that the formula all but automatically produces a return less than the 10% figure plugged into it. *See* Pet. App. 177a n.20, 184a, 198a.

In fact, the California Supreme Court's method of calculating the end result produces *negative* rates of return for petitioners Century-National, FARMERS, FEDERAL, GREAT AMERICAN, and HOME (based on the Commissioner's refund orders, the recorded actual profits for 1989, and the federal income tax rate).

[7] Several other suggestions made by the Commissioner, each wholly immaterial to the actual rationale of the decision below, underscore the indefensibility of that decision. The Commissioner casually suggests that 20% (the figure for 20th Century not disputed by the California Supreme Court) seems a rather high return for regulated industries (94-1119 Br. in Opp. 8 n.5), as if rates of return could somehow be assessed independent of the riskiness of the particular business at issue. In fact, the market-required return for low-risk utilities operating in monopoly markets can hardly be expected to mirror the market-required return for riskier insurers operating in competitive markets. The Commissioner also asserts that "the question of confiscation is not even implicated where an enterprise is not required to participate in the regulated market" (*id.* at 8 n.6), but that proposition—advanced only by Justice Mosk in the California Supreme Court and, to put it mildly, highly controversial in general and as applied to insurers in California—was not the basis of the decision below. Similarly, the Commissioner briefly intimates that the rollback limit might be excused because it is only "a one-year limitation" (94-1119 Br. in Opp. 12 n.9), but the California Supreme Court, far from accepting,

In short, there is no legitimate ground for treating the rationale the California Supreme Court gave for its judgment as anything but the clear holding of the decision below. The California Supreme Court clearly rested its ruling on the conclusion that the *Hope* cost-of-capital standard does not state a constitutional minimum. As the Commissioner's vigorous avoidance of that rationale indicates, the California Supreme Court's decision demands review.

CONCLUSION

For the foregoing reasons, and for the reasons set forth previously, the petition for a writ of certiorari should be granted.

Respectfully submitted,

KENT KELLER
ROBERT W. HOGEBOOM
STEVEN H. WEINSTEIN
BARGER & WOLEN
515 South Flower Street
Los Angeles, CA 90071

CARLA J. BENNETT
ADAMS, DUQUE & HAZELTINE
777 South Figueroa Street
Los Angeles, CA 90017

H. BARTOW FARR, III
(Counsel of Record)
RICHARD G. TARANTO
FARR & TARANTO
2445 M Street, NW
Washington, DC 20037
(202) 775-0184

Dated: January 1995

---

seems to have rejected any such suggestion (Pet. App. 80a & n.19), which, indeed, is inconsistent with this Court's holding that a temporary taking is nonetheless a taking. *First English Evangelical Lutheran Church v. Los Angeles*, 482 U.S. 304 (1987).